

**01344**

**1991/02/10**

781

E2

Bureau of Intelligence and Research

## WEEKEND EDITION

ENCISE



DEPARTMENT OF DEFENSE

February 1991 IS, FPC/CDR 18 Date: 12/5/96

RELEASE  DECLASSIFYEXEMPTIONS  DOWNGRADE TS TO C. CHINESE UNNY  DOWNGRADE IN PART FOIA Exemptions  (b) 1, 3, 5 EA Exemption  (b) 2, 4, 6, 7C

TS authority to

(b) CLASSIFY AS (b) S or

(b) DOWNGRADE TS to (b) S or

## China's Forecast: Cloudy, With Summer Storm Possible

Over the next several months, Beijing is likely to face a protracted series of challenges, including a moderate resumption of inflation, difficult personnel choices, and complex foreign policy decisions. The relatively weak Chinese leadership probably will continue to avoid tough choices while it tries to portray an image of unity and stability.

Should the worst case occur—a sudden surge of inflation, heightened leadership infighting over suc-

cession-related personnel and policy issues, renewed pressure from the US and the prospect of losing MFN or having unacceptable conditions attached to its renewal, the death of one or more key leaders—China could face a summer of crisis.

The Cultural Revolution, Democracy Wall, and Tiananmen all



Problems of Communism May-June 1990

President Yang Shangkun (left), Deng Xiaoping (center), and party chief Jiang Zemin at the Fifth Plenum of the 13th Central Committee of the Chinese Communist Party on November 10, 1989.

Warning Notice: Sensitive Sources and Methods Involved

SECRET//NOFORN//NOCONTRACT//ORCON  
Declassify: 04/04/2014 (multiple sources)

94 D 427 17653

point to the dramatic rise of popular willingness to challenge the limits of a demonstrably divided central leadership.

China's leaders now are united in their commitment to keep politics within the party's inner councils, but their best efforts may not be good enough if China is faced with a confluence of contentious issues in a short time frame.

\* \* \*

### **Borrowed Time?**

China's retreat from the brink since June 1989 has been remarkable. Last December, Deng reportedly told President Yang Shangkun, Premier Li Peng, and party chief Jiang Zemin that they had done a better job in restoring China's stability and international prestige than even he had expected. The leadership's most important successes include:

- **Reduced inflation.** In 1990 the index of retail prices rose by only 2 percent compared with double-digit rates in 1988 and 1989, according to official Chinese data. Consumer inflation was central to the public alienation that fueled Tiananmen; credit for the drop belongs to the hardliners' austerity program, price controls, and maintenance of income subsidies.
- **Restored "stability."** Heavyhanded repression following the 1989 riots has gradually given way to more subtle measures, including heavy doses of political indoctrination and official pressure to conform or feign compliance. Few outbreaks of unrest have taken place since 1989; those that have were dealt with severely, resulting in hundreds of executions.
- **A facade of leadership unity.** Since the ouster of party chief Zhao Ziyang and his closest supporters immediately after Tiananmen, Beijing has deferred contentious leadership changes. The leadership has taken pains to hide its disagreements and to project an appearance of unity.
- **Improved international relations.** Beijing's temporizing has been rewarded by the slow

erosion of Western-imposed sanctions. Chinese leaders seem confident that remaining restrictions will be removed over time without the need for major concessions. Simultaneously, Beijing has taken advantage of opportunities such as the Gulf crisis to build its role as a world player and restore its relations with key powers, including the US.

Yet, Beijing may be living on borrowed time. Reducing inflation has increased unemployment and sharply slowed economic growth; government efforts to put industry on a moderate, stable growth path included a large increase in credit which now threatens the possibility of another bout of inflation. The ill health of several key leaders and the need to bolster the post-Deng leadership team may soon force Beijing to make controversial personnel changes. Slow but steady improvement in US-China relations may be severely tested this spring as Congress takes up the issue of renewing MFN trading status for China. The end or winding down of the Gulf war could make China's cooperation less important to the US.

### **Economic Dark Clouds**

**Stagnation...** Serious side effects have accompanied China's rather dramatic success in reducing consumer inflation. Strict credit and other controls imposed in late 1988 began to take hold in mid-1989. Decreased demand, particularly for investment goods, caused industrial growth to slow. During the six-month period ending March 31, 1990, industrial production increased by less than 0.5 percent compared with the same period in 1988-89. Industry began to recover in the second quarter, but signs of improvement were mainly superficial, and increases in output went almost entirely into inventory. Retail sales continued to decline, dropping by more than 3 percent in the first quarter of 1990.

**...leads to eased credit...** Shocked by stagnation, local authorities and enterprise managers put strong pressure on Beijing to ease open the credit spigot, especially for working capital. Some hardliners [redacted] argued for staying the austerity course. Premier Li

Peng, however, succumbed to the same intense political pressure that Zhao had faced: he authorized massive injections of new credit in an effort to jump-start the faltering economy. In the five quarters ending December 31, 1990, as much as 400 billion yuan—almost one-fourth of China's GNP—was pumped into the economy. Overall, the growth of new credit in 1990 exceeded that of 1988, when rapid consumer inflation led to panic buying, the political weakening of party chief Zhao, and the ascendancy of the hardliners.

Initially, much of the increase in credit went toward paying back taxes and clearing outstanding debts and was not reflected in increased production. Enterprises continued to appeal for more credit to meet their normal purchasing peak in the second half of the year. Pressure to increase credit allocations during the second half was intensified by bumper summer and fall harvests and the government's pledge to avoid issuing IOUs to farmers in lieu of cash payment for their crops.

Hoped-for increases in industrial growth did not become evident until late 1990; industrial production jumped 12.7 percent in October and 15 percent in November. Retail sales, however, continued sluggish, rising only 1.1 percent in the first 11 months of the year (after adjusting for inflation), indicating that production for inventory remained a serious problem.

**...and inflationary pressure.** The excessive expansion of credit has sparked fears of another round of inflation, beginning as early as midyear. Consumer goods prices in 35 major Chinese cities increased 3.6 percent in October and 5.3 percent in November compared with the same months in 1989, according to official Chinese data. The cost of living during January–November rose 3.4 percent.

The Chinese method of calculating inflation indexes, however, historically has failed to give timely warning. Among the factors raising the possibility that China is headed into another bout with inflation are

- **Relaxation of price controls.** Controls were maintained on many consumer prices through most of 1990, the increases occurred mainly



*Beijing Review, July 10-16, 1989*

Premier Li Peng.

toward the end of the year. Now, the government has announced its intention to move ahead with long-delayed price adjustments—including substantially increased prices for petroleum, steel, and coal—and to reduce consumer subsidies.

- **Credit lag.** Chinese economists calculate that it takes at least three months for increased credit to show up as increased production; six months for it to become manifest as an increase in the money supply; and even longer to result in higher prices. As a result, some Chinese analysts calculate, last year's massive infusion of credit is not yet fully reflected in retail prices.
- **Producer/consumer price lag.** Similarly, Chinese economists expect that increases in producer prices will take at least several months to show up in retail prices. Producer prices are now growing at twice the rate of consumer prices, according to Embassy Beijing. This inflationary pressure will be compounded later in the year by the impact of producer price increases already announced or planned by Beijing.
- **Savings slowdown.** Growth in personal savings in 1990 helped fund credit expansion without

spiking inflation. But the rate of growth is accelerating, and the central bank probably will be forced to print money this year in order to expand credit. A sudden loss of consumer confidence could result in a drawdown of savings and a surge of panic buying.

### Foreign Policy Storms ?

The major items on the bilateral agenda—human rights, trade, and arms sales—are issues placed there by the US. Attempts by Beijing to craft responses are likely to cause considerable dispute within the leadership.

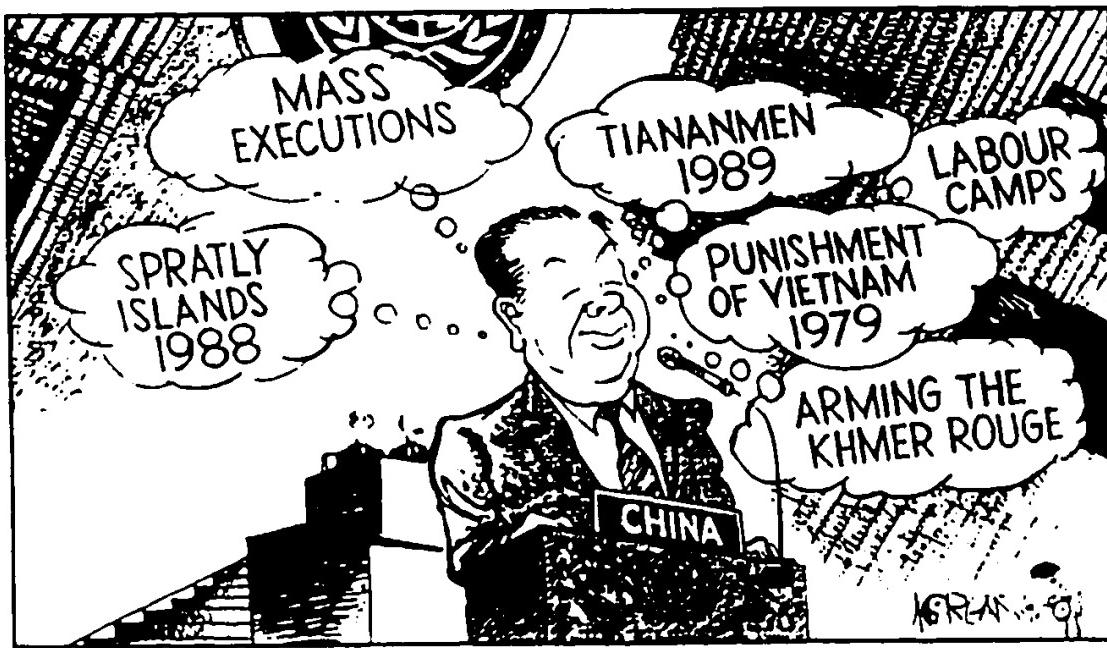
**Shifting ground.** Several areas which once were cornerstones of US-China cooperation—the strategic triangle, China's pursuit of economic reforms, and such regional issues as Cambodia—have changed in ways that have sharpened differences between Beijing and Washington. Warmer US-Soviet ties, for example, have severely weakened if not

eliminated China's role as a pivotal player on East-West issues.

The shift away from geostrategic cooperation as a basis for US-China ties has affected thinking in Beijing about the fundamentals of the relationship. Conservatives in the leadership claim that the US is attempting to subvert socialism through "peaceful evolution"; they voice related suspicions about US "hegemonic" ambitions—in the Gulf and more generally. The result has been a chilling effect on relations, despite private assurances that these arguments are primarily for domestic consumption.

**Divergent perspectives: Human rights...** The Federation for a Democratic China this year will focus its attention on attaching human rights-related conditions to renewal of MFN, according to leading dissident Wan Runnan. This strategy may be more successful than last year's call for outright revocation.

From Beijing's perspective, China has done a great deal to address US human rights concerns by



Far Eastern Economic Review, December 13, 1990

Foreign Minister Qian Qichen at the UN "China's consistent position... to try our utmost to seek a peaceful solution"

lifting martial law, allowing Fang Lizhi to leave Beijing, and being more lenient in sentencing convicted dissidents. Deciding on responses to US pressure on human rights continues to arouse controversy, with several elders arguing that China should resist US demands. As on other issues, Deng appears to hold the balance. This year, with trials for Tiananmen protesters expected to end by mid-February, Beijing may be less able to find easy concessions. Moreover, Deng and others in the leadership are more confident about China's international standing and therefore may be less inclined to make concessions to preserve MFN.

**...trade troubles...** Another contentious issue likely to be raised in the MFN context is China's trade surplus with the US. For 1990 the US trade deficit is expected to be about \$11 billion, almost double 1989's \$6.2 billion. The 1991 deficit could reach as high as \$15 billion, second only to the US deficit with Japan. The size and rapid growth of the deficit undermine Beijing's arguments that trade ties—particularly MFN—are of equal benefit to both sides.

Chinese officials argue that Tiananmen-related sanctions have caused the US trade deficit with China. They claim that if the US lifted technology transfer restrictions and granted soft loans, China would buy more from the US. In fact, much of the deficit is the result of China's policy of strictly controlling imports and aggressively pricing exports in order to fuel economic growth.

supporters see China's abstention on the UN vote on use of force in the Gulf as a successful example of this policy. They cite Foreign Minister Qian Qichen's official visit to Washington as a victory against sanctions.

Future Chinese involvement in Middle East arms proliferation could cause serious problems for US-China relations, particularly if Beijing sells ballistic missiles to Syria, Iran, or other countries, or delivers such systems as the M-9 which violate Missile Technology Control Regime guidelines. While Beijing in the past has responded to strong US pressure on missile sales on a case-by-case basis, its resentment of US "interference" combined with suspicion about Washington's motives have made it reluctant to join the MTCR or other multilateral efforts. Beijing probably would respond to any US sanctions over missile sales by threatening "retrogression" in the relationship and might even consider some form of economic or political retaliation.

#### Rough Seas for the Leadership

Immediately after the 1989 replacement of Zhao with Jiang as the "core" of the new leadership, party elders Deng and Chen Yun called for at least a two-year moratorium on leadership squabbling. Although jockeying for position in the succession has continued, sometimes intensely, evidence does not suggest an irreparable breach in or polarization of the leadership at this point.

Domestic economic problems and the prospect of losing MFN, or suffering unacceptable linkage of its renewal to changes in internal policies, could widen differences among top leaders. Debate would sharpen over economic strategy and foreign policy, which rely on heavy involvement in the international economy and close ties to the US and its market.

**A personnel plenum?** No replacements have been named for three former Politburo members: Hu Yaobang, who died in 1989; and Zhao and Hu Qili, removed after Tiananmen. Today's Politburo is both one of the smallest in recent history and the most top heavy. Six of the 14 members hold concurrent post-

[REDACTED]

**...and the Gulf and arms sales.** Deng supports a strategy of using China's position on the UN Security Council to maximize its international influence and improve relations with the US. Deng and his

tions on the Standing Committee. Since Zhao's removal, the party has held three full Central Committee sessions. Two dealt with economic affairs and one with measures to improve the party's public image. It seems increasingly likely that the next plenum—which could come as early as March—will deal with long-deferred personnel issues.

Several Politburo members are ripe for removal:

- Vice Premier Yao Yilin, a Standing Committee member and longtime advocate of greater central planning [REDACTED] In recent months he has appeared only rarely in public and, [REDACTED]
- Defense Minister Qin Jiwei has been in limbo since he apparently opposed the use of force against the Tiananmen protesters.
- Sichuan provincial party secretary Yang Rudai has been an absentee member since his appointment in 1987. He apparently received his Politburo billet principally because of his close relationship with Zhao.

Rumors have also circulated of a decision in late 1990 that aged and ailing Vice President Wang Zhen, Central Advisory Commission Chairman Chen Yun, and other elders might retire this year. [REDACTED]

Others are due for promotion:

- State Planning Commission Chairman Zou Jiahua has taken up much of the slack for Yao Yilin in conducting the State Council's day-to-day business. He is a good bet for promotion to Vice Premier, which usually carries with it membership on the Politburo.
- Foreign Minister Qian Qichen has been widely rumored to be in line for promotion to Vice Premier and Politburo member as a reward for engineering China's return to international respectability.

- Politburo alternate Ding Guangen recently has resumed broad responsibilities for relations with non-Communists and intellectuals as well as for China's relations with Taiwan, Hong Kong, and the overseas Chinese community. He could be in line for promotion to full Politburo membership.
- Regional officials associated with reform and moderation may garner higher representation on the Politburo, possibly including Guangdong Governor Ye Xuanping and Shanghai party chief Zhu Rongji.
- Wang Zhaoguo recently returned to a key party job in Beijing following several years as a provincial official. He probably is in line for promotion to the party's Secretariat, if not the Politburo.
- Hardliners have been pushing for promotion of younger ideologues, including State Council spokesman Yuan Mu and Propaganda Department Director Wang Renzhi.

A contentious process. High-level personnel changes in China are contentious in the best of times. Given the likelihood that the succession will take place soon, and the unresolved Tiananmen tensions in the leadership, the stakes are higher than usual. Leaders will be trying to bolster their positions by elevating their proteges and blocking promotions for their rivals' supporters. Heavy tradeoffs and sometimes unpredictable shifts in alliances are likely.

Since June 1989, Deng apparently has blocked almost all high-level changes out of a desire not to signal instability to the restive public and out of fear that he might lose more than he would gain by a reshuffling of the leadership. Now, politically somewhat recovered from his Tiananmen setback, he may feel the time has come to push through some leadership changes. But he still is politically weaker and more beholden to other elders than before Tiananmen, and any deal he is able to put together is likely to be the result of heavy compromises with more conservative elders. The result may be that no leader will gain

enough political support within the Politburo to win a post-Deng showdown with opponents.

#### The Mortality Wild Card

Deng, Chen Yun, and several other octogenarians have been in indifferent health since Tiananmen. Deng, although reportedly intervening more actively in political decisions in recent weeks, apparently has suffered several bouts of serious illness, possibly including one or more strokes. [REDACTED]

Either could pass from the scene suddenly, with dramatic implications for infighting and the balance of power in Beijing.

Equally important—and perhaps even more destabilizing—would be the sudden death or incapacitation of such key successors as Yang Shangkun (83), Jiang Zemin (63), or Li Peng (62). None of the three is believed to suffer life-threatening health problems—indeed, Yang is remarkably hearty for a man of his age. But both Jiang and Li reportedly have at least minor heart conditions.

(C. Clarke and D. Kingsland, INR/EAP)